

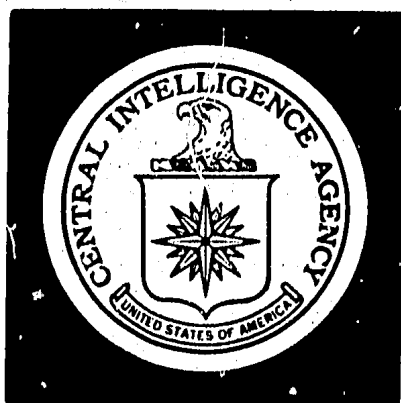
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Intelligence Memorandum

India's Cotton Textile Industry: Problems And Prospects

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June 1971

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CENTRAL INTELLIGENCE AGENCY

Directorate of Intelligence

June 1971

INTELLIGENCE MEMORANDUM

INDIA'S COTTON TEXTILE INDUSTRY:
PROBLEMS AND PROSPECTS

Introduction

1. India's cotton textile industry is the nation's largest industry in terms of employment and production and remains almost exclusively in private hands. Its postwar development reflects the government's partly conflicting economic policies. Import restrictions have protected the industry from foreign competition, but, at the same time, licensing and price and distribution controls have severely limited its expansion and modernization. A unique feature of the industry's evolution has been a trend toward small-scale, labor-intensive establishments. This trend - quite the reverse of the trend worldwide - reflects New Delhi's deliberate efforts to find jobs for its burgeoning labor force. This memorandum reviews briefly the industry's progress since independence and examines the government policies that have influenced this progress. It also analyzes the major problems facing large-scale producers 1/ and evaluates the short-term prospects for the industry's growth. ✓

Discussion

Background

2. At independence in 1947, India's well-developed cotton textile industry was second in size only to that of the United States. About 80% of total cloth production of 5 billion linear meters was produced by large mills, and the remainder was scattered among numerous small producers. The large mills were concentrated in the Bombay and Madras regions,

1. Including establishments with power equipment and more than 50 workers and those without power equipment and more than 100 workers. All other cotton textile establishments are classified as "small scale."

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identified at the time throughout the world with high-quality fabrics. Cloth production met not only domestic demand but allowed for considerable exports. During 1948-50, export earnings from cotton cloth averaged \$140 million annually, about 17% of total export earnings. India was the world's second largest textile exporter, with about 11% of the market.

3. As the country's leading industry, cotton textiles accounted for 40% of industrial production, 40% of industrial employment, and 35% of the nation's capital assets in 1948. The industry was owned and managed largely by Indians, with only 10% foreign-owned, mainly British. Most foreign capital was concentrated in jute and tea.

4. The industry is still the nation's largest. Although there has been some geographic dispersion, the industry is still concentrated around Bombay, Ahmadabad, and Madras (see Figure 1). But its relative position has declined substantially as heavy industry has grown more rapidly. Moreover, India's share of the world cotton cloth market has declined greatly and India's textile industry has not participated in the trend toward capital-intensive operations or the spread of synthetic fibers that has characterized other textile-exporting nations.

Production Trends and Government Policies

5. Over the past two decades, the growth of India's cotton textile production has been erratic (see Figure 2). Cotton cloth production increased by an average of better than 8% annually during 1951-55, but slowed to 1% in the next five years, then averaged 3% during 1961-65. Production declined sharply during the recession of 1966-67, recovered in 1968, and has since stagnated. In the entire period of the 1960s, production failed to keep up with population growth.

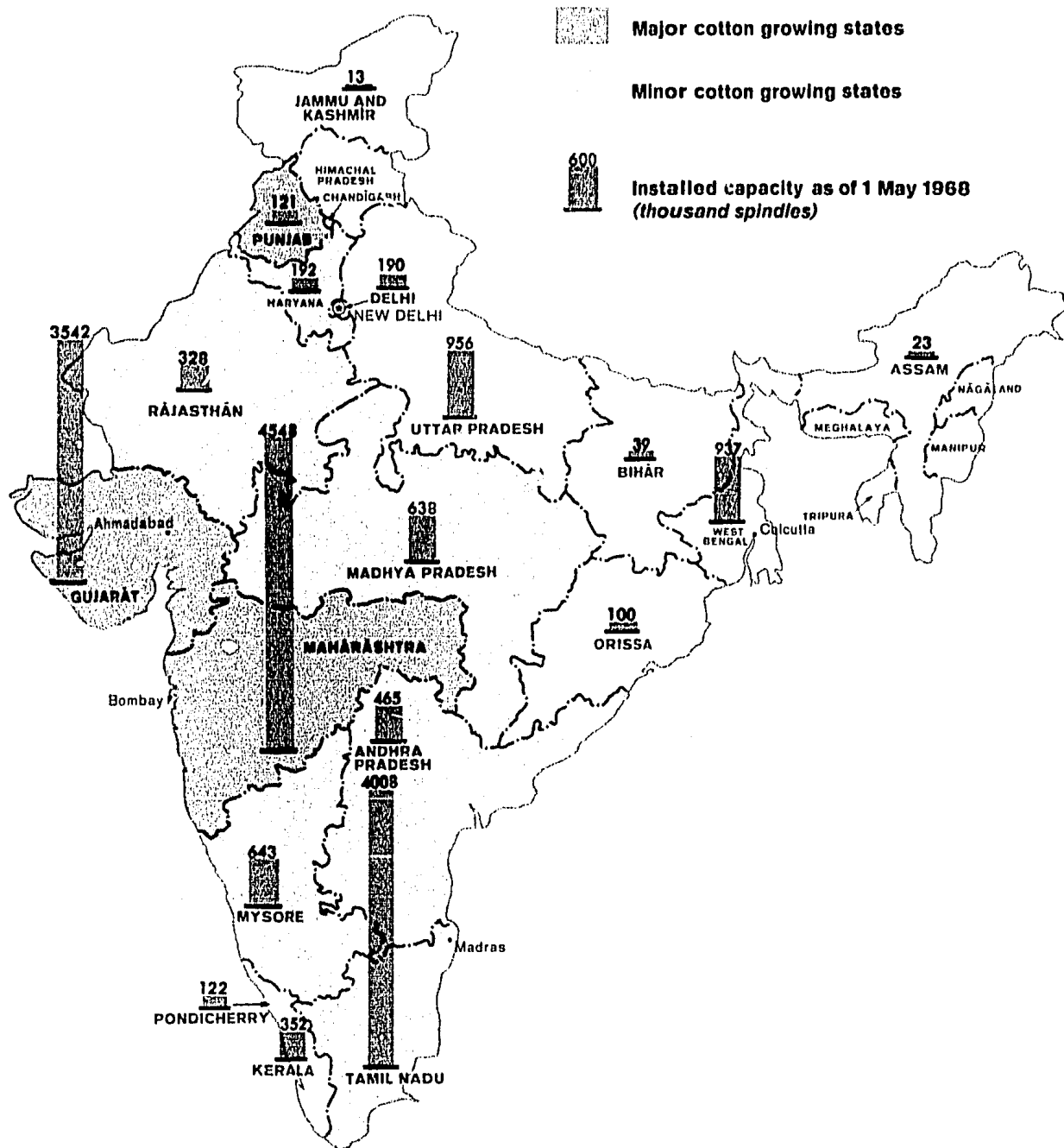
6. Consumer demand does not appear to have been a decisive factor in the industry's erratic performance, as both population and national income have risen fairly steadily. Rather, ambivalent government policies have at times encouraged and at other times inhibited the industry's development. Although the industry is protected against foreign competition by import prohibitions, the development of the large-scale sector and its operations in the domestic market have been proscribed – at least since the mid-1950s – by extensive controls. At the same time, the small-scale sector has benefited from government subsidies and a rapidly growing share of the domestic market.

7. The squeeze on large producers began in the mid-1950s when New Delhi placed emphasis on heavy industry, public sector investment, and activities that would generate large employment. The textile industry, as an already developed consumer goods industry, was given a low priority for investment. These policies were enforced by regulations restricting

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Figure 1

INDIA: TEXTILE INDUSTRY

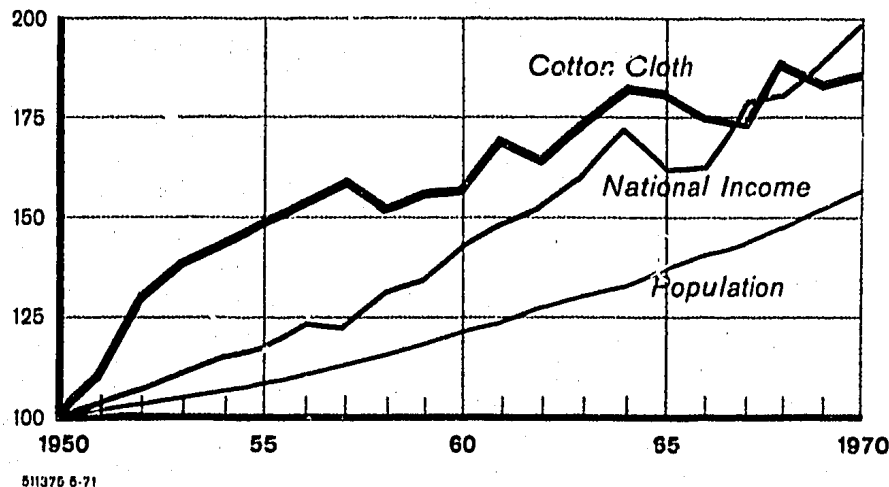


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Figure 2

**India: Indexes of Cotton Cloth Production,
National Income, and Population
(1950=100)**



expansion of capacity through licensing requirements and various selective procedures favoring small, labor-intensive operations. Furthermore, imports of machinery, spare parts, and production materials were strictly regulated, with importers required to prove that such goods were not available domestically.

8. Reflecting these government actions, cotton cloth production by the large mills actually declined after 1957 (see Figure 3), and their share of total cloth production fell from 73% in that year to 54% in 1970. On the other hand, small-scale production about doubled by 1970.

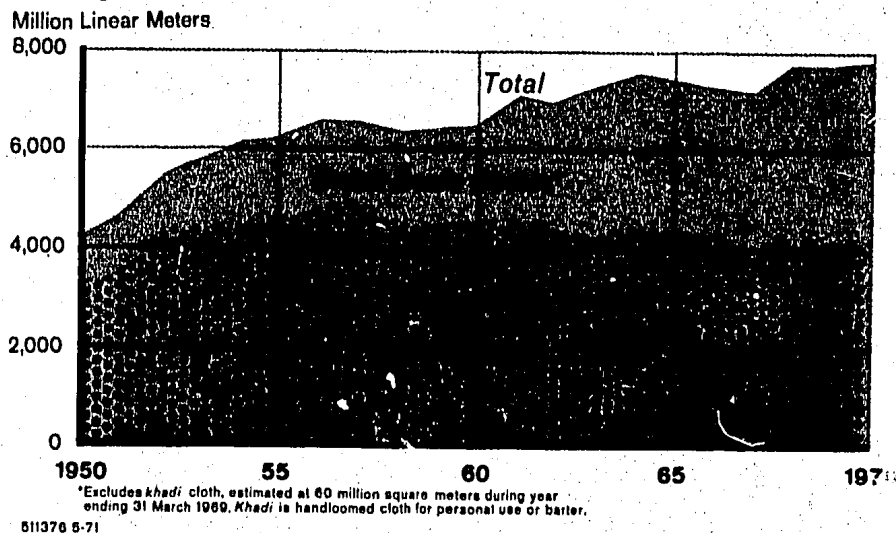
9. Fragmentary data suggest that investment in the large-scale sector has generally been limited to increased spindleage used to produce yarn required by the growing small-scale sector. The number of spindles neared 18 million in 1970, compared with 12 million in 1955 (see Table 1). Spinning mills proliferated during those years and cotton yarn production increased fairly steadily during the past two decades (see Figure 4). But the number of composite mills, which weave cloth as well as spin yarn, has remained virtually unchanged.

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**India: Cotton Cloth Production,
by Sector**

Figure 3



10. Except for the government's estimates of cotton cloth production, few data are available on the small-scale sector, which New Delhi defines as including all firms employing less than 50 workers with the aid of power or less than 100 workers without the aid of power. ^{2/} Small firms are dispersed more widely than large firms, with many located in rural areas. Indian sources estimate that the sector now employs about 6 million workers, including about 3 million part-time workers. This compares with only about 900,000 employees in the large-scale sector in 1970, only slightly more than in the early 1950s. Small-scale employment may have doubled since the mid-1950s as did output.

2. *Excludes khadi cloth which is handloomed cloth for personal use or barter and generally only a part-time household occupation. Khadi cloth production is less than 1% of the country's total cotton cloth output.*

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Table 1

India: Large-Scale Cotton Textile Mills
as of 1 January

Year	<u>Spinning Mills</u>		<u>Composite Mills</u>			<u>All Mills</u>	
	<u>Mills</u>	<u>Thousand Spindles</u>	<u>Mills</u>	<u>Thousand Spindles</u>	<u>Thousand Looms</u>	<u>Mills</u>	<u>Million Spindles</u>
1950	94	1,860	268	8,695	191	362	10.6
1951	103	1,843	275	9,156	195	378	11.0
1952	107	1,911	276	9,341	196	383	11.3
1953	113	1,947	282	9,476	198	395	11.4
1954	114	2,097	286	9,554	202	400	11.7
1955	116	1,768	292	10,190	203	408	12.0
1956	121	1,857	291	10,194	203	412	12.1
1957	144	2,195	292	10,297	201	436	12.5
1958	175	2,557	295	10,497	201	470	13.1
1959	188	2,807	294	10,599	201	482	13.4
1960	186	2,931	293	10,619	200	479	13.6
1961	192	3,056	287	10,607	199	479	13.7
1962	196	3,188	285	10,645	199	481	13.8
1963	211	3,394	287	10,723	200	498	14.1
1964	223	3,550	291	11,111	203	514	14.7
1965	253	3,941	290	11,492	206	543	15.4
1966	283	4,362	292	11,756	209	575	16.1
1967	317	4,653	292	11,989	207	609	16.6
1968	346	5,012	289	12,073	208	635	17.1
1969	358	5,249	289	12,157	208	647	17.4
1970	366	5,463	290	12,205	208	656	17.7

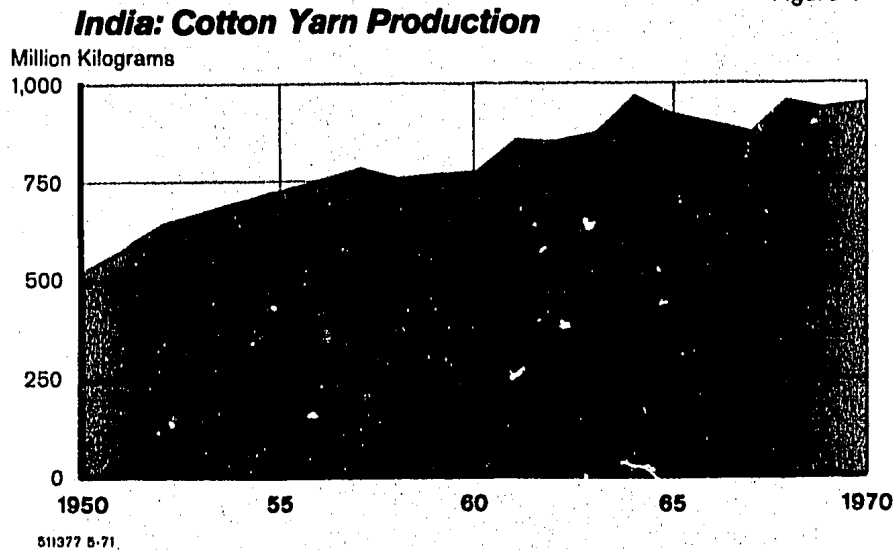
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Figure 4



Current Problems of the Large-Scale Sector

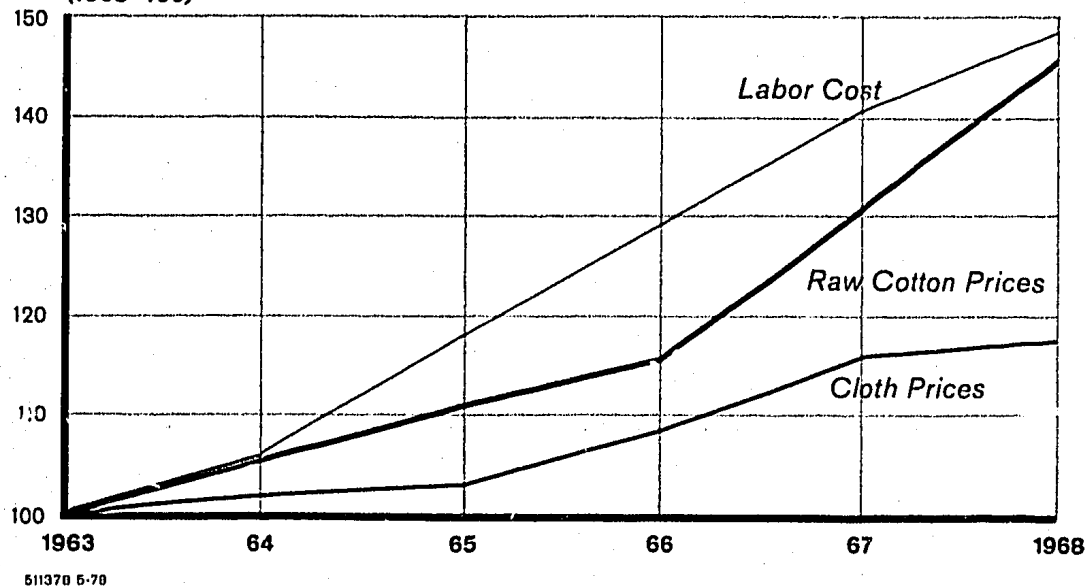
11. Government restrictions on the large-scale sector not only have constrained production but also have jeopardized the continuing private operations of the mills. Indeed, mill failures reached such proportions that in 1969 the government established the National Textile Corporation (NTC) to manage "sick" private textile mills. By December 1970 the NTC was operating 24 textile mills. The mills were to revert to private ownership as soon as they were again profitable.

12. Profit rates in the large-scale textile industry generally ranged below those for other industries throughout the 1960s. This reflected a cost-price squeeze, as both labor and raw material costs rose faster than cotton cloth prices. Raw cotton prices and wages increased 45% and 48%, respectively, between 1963 and 1968, while cotton cloth prices increased only 17% (see Figure 5). The trends in wages, clearly in excess of productivity gains, reflect primarily wage adjustments in accordance with

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Figure 5

**India: Cost and Price Indexes for Large-Scale
Cotton Textile Mills
(1963=100)**



changes in the cost of living. The squeeze on profits most likely continued through 1969 and 1970. Although cotton cloth prices may have risen somewhat - as discussed below - cotton shortages have raised the price of raw cotton even further, and wages increased at least in line with the substantial rises in consumer prices.

13. The price of cotton cloth has been deliberately held down by New Delhi's "cheap cloth" policies. Because cotton textiles are an important component in consumer purchases and their prices have a substantial impact on the cost of living, maintaining an adequate domestic supply of inexpensive cloth has been a major government objective. The greater profitability of higher quality cloth caused the large-scale sector to restrict low-quality cloth production. Because small-scale manufacturers could not keep up with the expanding markets, there were shortages of low-priced, low-quality cloth. In 1964 the government acted to halt this trend by

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requiring that at least 40% of each mill's output be of specified varieties -- generally of low quality -- to be sold at controlled prices. The so-called "cotton fabric price control quota" was reduced to 25% in May 1968 in the wake of increasing mill failures, and average prices may have risen in 1969-70. There is no evidence, however, that the mills' profit picture improved much, partly because of a sharp rise in cotton prices.

14. The two-year drought of 1966-67 cut domestic cotton production by about 15%. Although most agricultural crops have since surpassed their 1965 production levels by large margins, cotton production last year was still about 10% below that level. Lower cotton production resulted primarily from competition for land from wheat, which benefited from higher government support prices and greater yields from improved seeds. Under normal circumstances, reduced cotton production and an accelerating domestic demand for cotton textiles brought on by rising incomes would signal higher imports. But the government's restrictive import policy reduced cotton imports in 1966-70 (see Figure 6) by an average of almost 25% from the preceding five-year period. As a result there was an acute cotton shortage. Supplies of domestically grown short staple cotton, which is generally suited to the small-scale sector, dropped only slightly. The large-scale sector, however, which needs imports of long staple cotton to manufacture high-quality, higher priced cloth was hard hit.

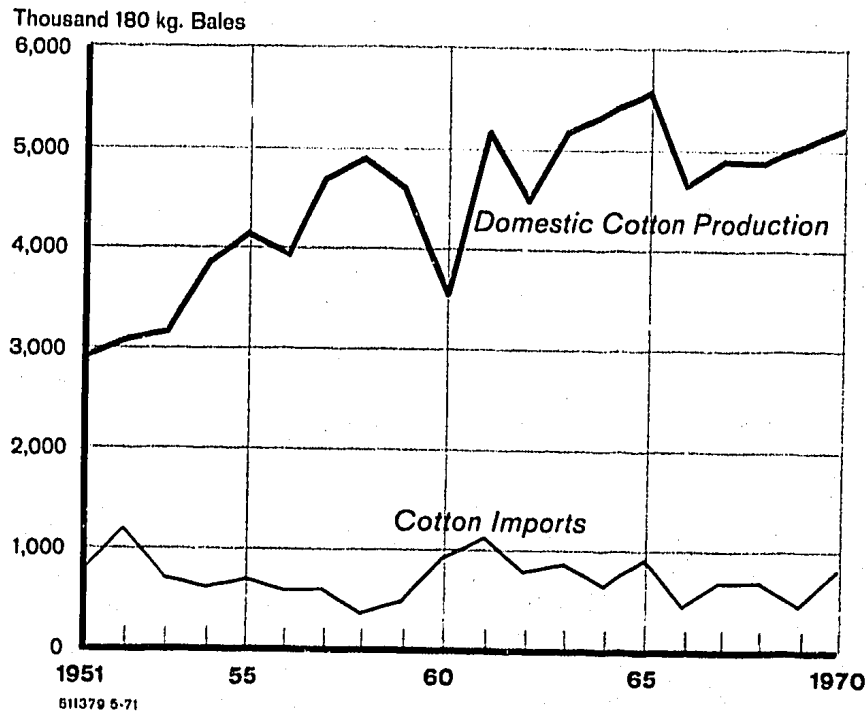
15. The cotton shortage reached crisis proportions in early 1971, when domestic raw cotton prices averaged about 50% above the previous year. Prices of uncontrolled piecegoods rose 25% to 60% from October 1970 to February 1971. Since profits on the sale of high-grade cloth at these higher prices more than compensated for the small fine levied by the government for underproduction of cheap cloth, mills generally stopped producing their quota. To combat this situation, the government demanded in April that the mills increase production of quota cloth or face higher penalties. Cheap cloth production was to be subsidized jointly by the mills producing higher quality cloth and by the government. In addition, the government took over most of cotton imports and promised increased purchases from abroad. Increased production of quota cloth will probably depress sales of higher quality cloth, lowering industry profits which, in turn, will reduce the incentives to expand and modernize.

16. In addition to a cost-price squeeze on profits, government policy also has shaped the mill owners' attitude toward modernization and production for export. Restrictions on textile imports gave local producers a monopoly in the vast domestic market. At the same time, restrictions on capacity expansion through various licensing procedures effectively discouraged producers from modernizing their plants. Less than 20% of India's looms are automatic, compared with 100% for the United States and Hong Kong and 70% for Pakistan. Most of the industry's power

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India: Raw Cotton Availability

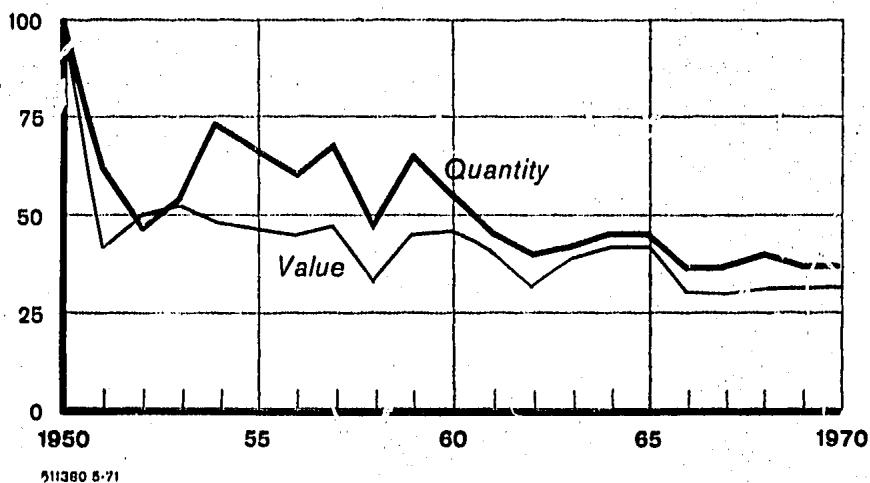
Figure 6



equipment is of pre-World War II vintage. For example, only one-quarter of carding machines are postwar models and nearly half the speed frames are 40 years old. Furthermore, lack of investment and inability to import chemical fibers prevented the textile industry from following the worldwide trend toward synthetic textiles. In 1968, rayon and other synthetics represented only 10% of the fibers used in yarn production in India, compared with about 50% in Japan and over 40% in Taiwan. For all these reasons, India's share of the world cotton textile market was only 4.2% in 1968, compared with 11.3% in 1948-50, and India's exports of cotton cloth have declined by about two-thirds during 1951-70 (see Figure 7).

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Figure 7

India: Indexes of Quantity and Value of Cotton Cloth Exports (1950=100)Cotton Textiles in the Fourth Five-Year Plan

17. India's Fourth Five-Year Plan (fiscal years 1969-73 ^{3/}) provides for the continuing promotion of the small-scale sector, but incorporates the hope for a substantial increase in large-scale textile production as well. The plan, published in final form in 1970, projects an 8%-10% annual increase in industrial production, with production of cotton textiles increasing at an average rate of 2-1/2%-3%. Growth of small-scale production (3-1/2%) was projected to exceed that of large-scale production (about 2%).

18. Now that the economy is two years into the plan, it is clear that the cotton textile targets are virtually beyond reach. Not only were the benchmarks used by the planners for the fiscal year (FY) 1968 overstated, but also progress during 1969 and 1970 has been well below expectations (see Table 2). To achieve the fiscal year (FY) 1973 target of 9.4 billion meters of cloth, the growth of production would have to average more than 6% annually during the last three years of the plan period.

3. The fiscal year begins 1 April of the stated year.

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Table 2

India:
Cotton Textiles in the Fourth Five-Year Plan
FY 1969-73

	<u>Million Linear Meters</u>		
	<u>Total</u>	<u>Large Scale</u>	<u>Small Scale</u>
FY 1968 benchmark	8,193	4,597	3,596
1968 actual	7,896	4,366	3,530
1970 actual	7,805	4,205	3,600
FY 1973 target	9,350	5,100	4,250

19. The planned expansion of the small-scale sector was to be achieved with continuing government assistance, including excise tax reductions, concessional credit schemes, direct subsidies, and arrangements to ensure the supply of raw materials and equipment. At the same time, the small-scale sector would continue to have a monopoly "on production of specified varieties of cloth already reserved exclusively for the handloom sector." The government is also engaged in designing and developing improved spinning wheels and subsidizing their sale.

20. With respect to the large-scale sector, the plan provided only for an appropriation to the National Textile Corporation to "help reconstruct viable but sick mills." Otherwise, the plan indicated only that existing financial institutions could support the modernization needs of the large-scale mills, suggesting that production goals could be achieved without a significant expansion of capacity.

Prospects

21. Government discrimination in favor of the small-scale cotton textile sector is likely to succeed in expanding both production and employment in that sector, but at the expense of a continuing deterioration of large-scale mills. Small-scale sector growth cannot possibly keep pace with domestic demand for cotton cloth; shortages and rising prices -- especially for higher quality fabrics -- are inevitable unless production in the large-scale sector accelerates.

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22. A review of the Fourth Five-Year Plan currently underway probably will not stimulate those policy changes essential for the large-scale sector to grow. The profit squeeze could be eased in a variety of ways, most dramatically by raising the price ceilings that are a part of the "cheap-cloth" quota system. But instead New Delhi has recently tightened them. Wage controls are another way, but this does not appear politically acceptable. Liberalization of the government's restrictions on imports could free the foreign exchange needed for textile machinery to modernize the antiquated mills, but with a protected market, mills would probably be slow to respond. Some liberalization of the licensing requirements for expansion would permit the more profitable large firms to meet rising demand, but the government is unlikely to do this.

23. Liberalizing policies toward the large-scale firms would necessarily detract from government efforts to promote the small-scale sector. The commitment to the latter involves the government's desire to expand employment opportunities in both rural and urban areas quickly. Furthermore, the existing restrictions on the large-scale mills are typical of India's policies toward the private sector generally -- to restrict the growth of concentrations of wealth.

24. It is possible, but not likely, that the Indian government will opt to resolve the dilemma by nationalizing the large-scale sector of the industry. The National Textile Corporation, charged with taking over "failing and mismanaged" mills, could become the instrument of nationalization if mill failures multiply under the cost-price squeeze. Nationalization, however, would not constitute a panacea for the industry, as India's public sector in general has been notoriously inefficient.

Conclusions

25. Postwar development of the Indian textile industry reflects the Indian government's simultaneous attempts to raise output, maximize employment, minimize imports, prevent the growth of private economic power, and reduce inequality in income distribution. These objectives were partly conflicting and could not all be achieved. India was successful in greatly increasing textile employment. But in the 1960s, per capita textile output and textile exports fell, and technology in the industry was stagnant.

26. The structure of India's cotton textile industry has changed dramatically since the 1950s as a result of government policies favoring small firms and restricting the growth of large firms. By 1970, small firms

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were producing about 45% of the nation's cotton cloth and accounted for all of the increase in production since 1957. The large-scale sector has been allowed only to expand its spindleage capacity to provide yarn for small firms.

27. While the small-scale sector has benefited from various subsidies and a monopoly on the production of certain cloth varieties, the large-scale sector has experienced a cost-price squeeze, culminating in numerous mill closures during the late 1960s. The failure of cotton textile production to grow during 1969-70 was a significant factor in the sluggish growth of India's total industrial production during those years.

28. The continuing growth of the small-scale sector has probably doubled employment in that sector. However, it has restricted the growth and modernization of the textile industry as a whole, which, in turn, has lost the country the benefits of faster industrial expansion, increased exports, and those increased employment opportunities that would have accrued to the economy from the multiplier effect of such an expansion. The large-scale mills will remain in the doldrums if the government follows existing policies and implements the additional restrictions placed on the industry early this year. Thus the growth of industry in the near term is heavily dependent upon government policy, and the trend, so far, appears to be toward more and tightening restrictions.

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